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AVIATION COMPETITION

Challenges in Enhancing Competition in Dominated Markets

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We appreciate the opportunity to testify on some of the vexing issues of competition in the commercial aviation industry. Extensive research and the experience of millions of Americans underscore the benefits that have flowed to most consumers from the 1978 deregulation of the airline industry, including dramatic reductions in fares and expansion of service. These benefits are largely attributable to increased competition--by the entry of both new airlines into the industry and established airlines into new markets. At the same time, however, airline deregulation has not benefited everyone; some communities?particularly small and medium-sized communities in the East and upper Midwest--have suffered from relatively high airfares and a loss of service due in part to a lack of competition.

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Mr. Chairman and Members of the Committee:

We appreciate the opportunity to testify on some of the vexing issues of competition in the commercial aviation industry. Extensive research and the experience of millions of Americans underscore the benefits that have flowed to most consumers from the 1978 deregulation of the airline industry, including dramatic reductions in fares and expansion of service. These benefits are largely attributable to increased competition--by the entry of both new airlines into the industry and established airlines into new markets. At the same time, however, airline deregulation has not benefited everyone; some communities—particularly small and medium-sized communities in the East and upper Midwest--have suffered from relatively high airfares and a loss of service due in part to a lack of competition.

During the past 12 months, four major U.S. passenger airlines have announced proposed mergers and acquisitions. In May 2000, United Airlines (United) proposed to acquire US Airways and divest part of those assets to create a new airline called DC Air. More recently, American Airlines (American) has proposed to purchase Trans World Airlines (TWA) along with certain assets from United.[1] The potential shifts in industry structure that would result from the proposed mergers represent a crossroads for the structure of the airline industry and the state of competition and industry performance. These proposals have raised public policy questions about how such consolidation within the airline industry could affect competition in general and consumers and small communities in particular.

The Congress has long been concerned about ensuring that the airline industry remains vibrant and competitive. The bill now before the committee—The Aviation Competition Restoration Act (S. 415)—expresses that concern by focusing on airline market concentration. The bill would require the Department of Transportation (DOT) to assert its authority in analyzing and overseeing competition in the airline industry. It would generally prohibit airlines from merging or acquiring the assets of another airline if the resulting carrier met certain tests of market strength and the Secretary of Transportation determined that the acquisition would substantially

[1] Technically, American has proposed to acquire the assets of TWA, which declared bankruptcy. For presentation purposes in this statement, however, we will refer to the transaction as a merger.

lessen competition or result in unreasonable industry concentration or excessive market domination, unless the merging airlines were willing to surrender gates, facilities, and other airport access to smaller carriers. The bill would also require the Secretary to investigate the assignment and usage of gates, facilities, and other assets by airlines that have dominant market positions at large airports. The bill would then have the Secretary require those airlines to surrender gates and other airport assets upon request of another airline or the Secretary's own motion if gates and other assets are not available and competition would be enhanced.

GAO has analyzed aviation competition issues since enactment of the Airline Deregulation Act. Last month, we testified before this committee on how the proposed consolidation in the industry might affect competition.[2] In December 2000, we issued a report on the potential effects of the proposed merger between United Airlines (United) and US Airways.[3] Our statement today is based on those products, earlier work on airline competition issues, and additional analyses of competition at key large U.S. airports. We will: (1) present an overview of the status of airline competition in markets to and from key large airports, (2) summarize federal oversight and enforcement of competition in the industry, and (3) provide some broad observations on the proposed legislation.

In summary:

- Major airlines dominated 16 of the 31 largest U.S. airports (i.e., the airlines carried more than 50 percent of the passengers), at which about 260 million passengers traveled in 1999. Moreover, these dominant airlines faced relatively little competition; another airline competed (i.e., carried more than 10 percent of the passenger traffic) at only 6 of the 16 dominated large airports. Low-fare airlines such as AirTran Airlines (AirTran) competed at just 3 of those 16 airports. Dominance at an airport, in and of itself, is not anticompetitive. Nevertheless, research has consistently shown that dominated airports tend to have higher airfares than airports that have more competition from other airlines. DOT reported earlier this year that passengers at 10 airports paid on average 41 percent

[2] *Airline Competition: Issues Raised by Consolidation Proposals* (GAO-01-370T, Feb. 1, 2001).

[3] *Aviation Competition: Issues Related to the Proposed United Airlines—US Airways Merger* (GAO-01-212, Dec. 15, 2000). See the list of related GAO products attached to this statement.

more than do their counterparts flying in markets where the dominant airline faces low-fare competition. In addition, dominant carriers often have exclusive access to essential facilities at airports as well as sales and marketing practices which combine to limit the ability of new or existing airlines to enter markets and compete with them.

- DOT generally has not taken enforcement action against airlines for alleged anticompetitive behavior concerning airline mergers and predatory practices. This includes the period during the 1980s when DOT approved a wave of mergers, such as TWA's acquisition of Ozark, as well as more recently with respect to its authority to prohibit unfair method of competition such as predatory practices. While DOT is not required to proactively take action to ensure or enhance competition, it has taken some actions more recently to enhance competition (e.g. using its authority to grant more slots to new entrants). In the past 3 years, the Department of Justice (DOJ) has twice brought lawsuits against airlines under its authority to enforce the federal antitrust laws.

- GAO and others have repeatedly found problems with fares, service, and access which the proposed legislation would address. While we have not reviewed the proposed legislation in detail, we agree with the intent of the legislation–i.e., to direct DOT to play an affirmative, activist and pro-competitive oversight role in airline competition. However, we have some concerns that the proposed legislation may be more prescriptive than necessary, with the result that the intended results may not be achieved and that some adverse unintended consequences might result. For example, it is not clear that the forced divestiture of airport facilities would necessarily result in real price competition in high-value markets because the new competitor may or may not have a cost advantage relative to the incumbent dominant airline. In addition, we are also concerned that forcing dominant airlines to provide access to other airlines at larger U.S. airports could result in the reduction of service to smaller communities. Finally, while the proposed legislation would make clear that Congress intends DOT to actively pursue investigations of potentially unfair competition, DOT may need additional resources to carry out the legislative intent.

Background

The U.S. air transportation structure is dominated by "hub-and-spoke" networks. Since the deregulation of U.S. commercial aviation in 1978, nearly all major carriers have developed such networks. By bringing passengers from a large number of cities to one central location and redistributing these passengers to their intended destinations, an airline's fleet can serve more cities than it could through direct "point-to-point" service. Hub-and-spoke systems provide travelers with more departure and arrival choices and generally allow the airlines to use their airplanes and other equipment more efficiently. Airline networks generally have several hub cities. For example, Northwest has hubs in Minneapolis, Detroit, and Memphis, and American has hubs in Chicago, Dallas, and Miami.

As we recently reported to this committee, if both the United-US Airways merger and American-TWA acquisition are consummated, new United would have the largest market share of any U.S. carrier—over 27 percent—and new American would have a 22.6-percent share. Each proposal could have both harmful and beneficial effects on consumers. The United and American proposals would each reduce competition in approximately 300 markets, with each affecting over 10 million passengers.[4] While the mergers would also each create new competitors in some markets and provide other benefits to consumers, substantial questions remain about how the profound structural changes would affect industry performance. These include the three issues we discussed with the committee last month: how a more consolidated industry might further raise barriers to market entry by new airlines, how the two merged airlines might compete in key markets, and how service to small communities might be affected.

Both DOJ and DOT have responsibilities for reviewing airline business practices. DOJ has the authority to institute judicial proceedings under the Clayton Act if it determines that a merger or acquisition may substantially lessen competition in a relevant market or if it tends to create a monopoly. DOJ also has the responsibility to enforce the Sherman Act, which prohibits

[4] To prepare the GAO products containing this information, we analyzed the most recent data available from DOT on the top 5,000 city-pair markets, which covered calendar year 1999. We recognize that competition or service in particular markets is likely to change over time with the entry or exit of different carriers. Carriers may add or reduce service in markets. These data illustrate the approximate orders of magnitude of the various transactions. We did not subtract passengers or markets that may be affected by DC Air markets or the proposed agreement between United and American to share the current US Airways shuttle from the data for new United.

unreasonable restraints of trade and attempts to establish and maintain monopoly power. DOT has authority to prohibit airline practices as unfair methods of competition if they violate antitrust principles, even if the practices do not constitute monopolization and attempted monopolization under the Sherman Act.[5]

Major Airlines Dominate a Majority of Large Airports

Major airlines dominated a majority of the 31 largest U.S. airports in which approximately 470 million passengers traveled in 1999.[6] Our analysis indicates that major airlines dominated 16 of those "large hub" airports, in which about 260 million passengers traveled.[7] Moreover, these dominant airlines faced relatively little competition.[8] At 9 of those 16 airports, the second largest airline carried less than 10 percent of passenger traffic. Only at Atlanta, Salt Lake City, and St. Louis did a low-fare airline such as AirTran or Southwest Airlines (Southwest) carry 10 percent

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[5] 49 USC 41712 (section 411 of the now-repealed Federal Aviation Act).

[6] Consistent with definitions that others (i.e., the Transportation Research Board) have applied in the past, we define an airport as "dominated" if a single airline carries more than half of the total passenger boardings or enplanements. Similarly, an airline would be defined as a "dominant airline" if it carried more than half of total passenger enplanements. "Passenger enplanements" represent the total number of passengers boarding an aircraft. Thus, for example, a passenger that must make a single connection between his or her origin and destination counts as two enplaned passengers because he or she boarded two separate flights. Data for the total number of passenger enplanements in these airports is for calendar year 1999, the latest data available from the Federal Aviation Administration.

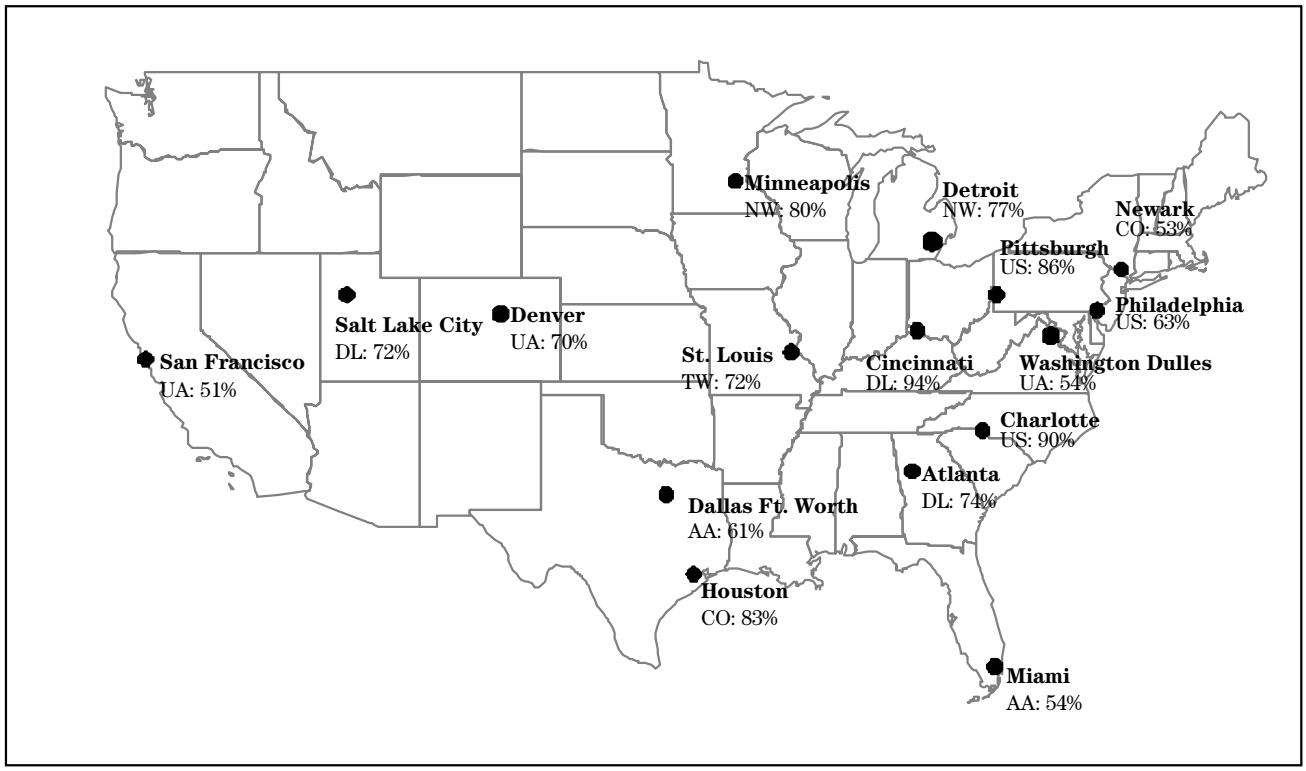
[7] "Large hub" airports are those defined in the US Code as having at least 1 percent of total annual passenger enplanements. Those hubs are not necessarily the same airports as those which airlines may identify as hubs within their networks ("airline hubs"). Of the 31 large hub airports, airlines label 21 as airline hubs. Each of the 16 large hubs that we identified above are dominated by the airline that runs its network hubs at those locations.

We calculated each airline's share of passenger traffic at each of the large hub airports using data from BACK Aviation Solutions. These data covered four quarters from the 4th quarter of 1999 through the 3rd quarter of 2000—the most recent data available at the time of our work. We confirmed each airline's dominance at these airports by examining current data on airline schedules from the Kiehl-Hendrickson Group. Those data reveal the total number of seats available for purchase by passengers on each airline, including their smaller code-sharing regional affiliates.

[8] As in our previous work and consistent with definitions applied by DOT and others, we define a competitor as an airline that carries at least 10 percent of total passenger traffic.

or more of passenger traffic.[9] Figure 1 shows the large hub airports dominated by each of the major US airlines, along with the market share of the dominant airline.

Figure 1: Dominated Large Hubs Airports



Legend: AA = American Airlines; CO = Continental Airlines; DL = Delta Air Lines; NW = Northwest Airlines; TW = Trans World Airlines; UA = United Airlines; US = US Airways.

Source: GAO analysis of data from BACK Aviation Solutions.

Notably, some of the country's very largest airports are not dominated by any single airline. These include Los Angeles International, New York LaGuardia, and Chicago O'Hare International. In addition, four major airlines—Alaska, America West, Southwest, and American Trans Air—dominate no large hub airport. Table 1 shows the large hub airports dominated by each of the major US airlines and the total (1999) enplaned passengers for the hubs of each carrier. Appendix I lists each of the 31 large hub airports and shows the percentage of passenger enplanements held by the two airlines that carried the most passengers there.

[9] Other airlines that DOT defines as being low-fare carriers include American Trans Air, Frontier, National, Spirit, Sun Country, Tower, and Vanguard.

Table 1: Airline Dominance at Large Hub Airports

Airline	Dominated large hubs	Total passengers enplaned (1999)
American	Dallas/Ft. Worth, Miami	44,636,299
Continental	Newark, Houston Bush Intercontinental	31,791,401
Delta	Atlanta, Cincinnati, Salt Lake City	57,881,013
Northwest	Detroit, Minneapolis	32,332,669
TWA	St. Louis	14,831,699
United	Denver, Washington Dulles, San Francisco	46,235,863
US Airways	Charlotte, Philadelphia, Pittsburgh	31,946,837
Total		**259,655,781**

Source: GAO's analysis of data from the Federal Aviation Administration and BACK Aviation Solutions

Should the proposed merger between United and US Airways occur, along with American's proposed acquisition of TWA, the dominance of the major airlines at these airports would increase. For example, the addition of US Airways' relatively small market share at Chicago O'Hare International Airport would then allow new United to control more than half of the scheduled domestic seating capacity there. New United's share of scheduled domestic seating capacity at Philadelphia would increase from 66.4 percent (US Airways' share of currently-scheduled capacity) to 72.8 percent. New American's share of scheduled domestic seating capacity at Washington's Reagan National would increase from its existing 12.1 percent to 36.6 percent of total scheduled seats; new United's share of scheduled domestic seating capacity at Reagan National would be 23.2 percent.[10]

Evidence of Market Power at Hubs – Higher Fares and Barriers to Entry

An airline's dominance of an airport alone, however, does not demonstrate its market power. One important indicator of the possible exercise of market power is what is known as a "hub premium," which represents the extent to which fares to and from hub cities are higher than average fares on similar routes throughout the domestic route system. Dominated airports tend to have markets with higher airfares than airports that have more competition from other

[10] New American's market share of Reagan National's capacity includes an estimate of the seating capacity that DC Air would hold (because of American's proposed equity partnership and planned marketing agreement with DC Air) along with half of the capacity of US Airways' Washington-New York-Boston shuttle operations, which it would obtain under an agreement with United. New United's market share of Reagan National's capacity includes its existing capacity with that of US Airways, adjusting for US Airways' divestiture of assets to DC Air and the agreement to split US Airways' shuttle operations with American.

airlines.[11] In 1999, the Transportation Research Board (TRB) confirmed that dominated hub markets (i.e., markets where either the origin or the destination is a dominated hub) tend to have higher airfares than other markets. This is especially true in short-haul markets.[12]

In January 2001, DOT concluded that high fares at dominated hub airports result, in large part, from the market power exercised by network carriers at their hubs.[13] Based on a comparison of fares at 10 dominated hub airports, DOT estimated that 24.7 million passengers in hub markets with no low-fare competitor paid on average 41 percent more than those flying in hub markets with low-fare competitors. Passengers in short-haul hub markets (750 miles or less) without a low-fare carrier on average pay even more. DOT concluded that the lack of price competition, and not other factors such as a concentration of high-fare business travelers, resulted in these higher prices. DOT reported that Cincinnati, Pittsburgh, Minneapolis, and Charlotte—four of the six hubs with the highest market shares of dominated carriers--have the highest overall fare differentials. (See Table 2.) DOT's report further observed that spoke communities may also be subject to higher fares when hub dominant carriers are the predominant service carriers at the spoke communities. Passengers on these routes are charged higher fares because they too do not benefit from aggressive price competition.

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[11]Several studies, including our own, have found that airfares in dominated city-pair hub markets are higher than those in markets with competition, when controlling for factors such as distance and traffic density. See for example *Airline Competition: Higher Fares and Less Competition Continue at Concentrated Airports* (GAO/RCED-93-171, July 1993). That report defined concentrated airports as one where an airline handled at least 60 percent of the enplaning passengers or two airlines handled at least 85 percent of the enplaning passengers. We concluded that these fares at these airports were generally higher than at airports with more competition. See also Severin Borenstein, *The Evolution of U.S. Airline Competition*, Journal of Economic Perspectives, Vol. 6, No. 2, Spring 1992). Borenstein concluded that hub-and-spoke networks are not just a source of increased production efficiency, but that they are also associated with airport concentration and dominance of a hub airport by one or occasionally two airlines.

[12]*Special Report 255 Entry and Competition in the U.S. Airline Industry: Issues and Opportunities*, Transportation Research Board, July 1999.

[13]*Domestic Aviation Competition Series: Dominated Hub Fares* (US Department of Transportation, Office of the Assistant Secretary for Aviation and International Affairs, January 2001).

Table 2: Fare Differentials at Dominated Hub Markets

	Percent difference in airfares: routes without low-fare competition vs. routes with low-fare competition		
Dominated hub	**Short-haul markets**	**Long-haul markets**	**All markets**
Cincinnati	78%	35%	57%
Pittsburgh	86%	18%	57%
Minneapolis	46%	63%	55%
Charlotte	75%	23%	54%
St. Louis	38%	61%	49%
Memphis	57%	29%	43%
Atlanta	49%	28%	41%
Detroit	51%	21%	40%
Denver	37%	28%	29%
Salt Lake City	-6%	6%	2%
All	**54%**	**31%**	**41%**

Note: These fare differentials were derived by comparing fares at dominated hub markets in which low-fare competition exists against fares at dominated hub markets in which no low-fare competition exists. All fare comparisons were controlled for distance and density.

It is important to focus on competition and possible pricing premiums in city-pair markets rather than the hub overall, since the existence of large hubs and the presence of low-fare competitors are not mutually exclusive. For example, in 3 of the 31 large hub airports (Baltimore, Las Vegas, and San Diego), Southwest carried the largest percentage of passenger traffic; in another four of the 31 large hubs, it carried the second largest percentage of passengers. Other low-fare airlines compete in some city-pair markets with the dominant airline in dominated hubs. In those markets, travelers experience lower airfares brought about by the presence of low-fare competition. Table 3 illustrates selected markets in which dominant airlines face competition from low-fare airlines with markets of similar distance in which the dominant airline faces no low-fare competition. For example, passengers traveling from Philadelphia to Atlanta appear to benefit from AirTran's competition against US Airways, which charged nearly the same average airfare in 2000. But passengers paid an average of $110 more to fly basically the same distance on US Airways from Philadelphia to Chicago, a market in which no low-fare competition exists.

Table 3: Comparison of Selected Hub Markets in Which Dominant Airline Faces Low-Fare Competition With Those in Which No Low-Fare Competition Exists

Origin	Destination	Distance	Passengers per day (one way)	Average fare[1] (airline)
Atlanta	Boston	945	1,130	$104.67 (AirTran) $153.85 (Delta)
	Providence	902	82	$207.05 (Delta)
Dallas	Chicago[2]	795	576	$137.11 (American Trans Air) $177.28 (American)
	Indianapolis	756	135	$254.04 (American)
Denver	Omaha	470	225	$141.95 (Frontier) $171.30 (United)
	Oklahoma City	493	79	$244.46 (United)
Detroit	Tampa	985	549	$103.92 (Spirit) $130.77 (Northwest)
	Dallas	981	434	$234.56 (Northwest)
Houston[3]	Baltimore	1,232	392	$141.10 (Southwest) $215.01 (Continental)
	Pittsburgh	1,124	117	$328.20 (Continental)
Philadelphia	Atlanta	666	1,164	$92.71 (AirTran) $105.64 (US Airways)
	Chicago[4]	676	910	$216.18 (US Airways)

[1]Data for passengers and fares are for the period from the fourth quarter of 1999 to the 3rd quarter of 2000.

[2]Fares and passenger totals shown are for ATA and American's service to Chicago's Midway Airport. American carried most of its Dallas—Chicago passengers to O'Hare International Airport, for an average fare of $280.70.

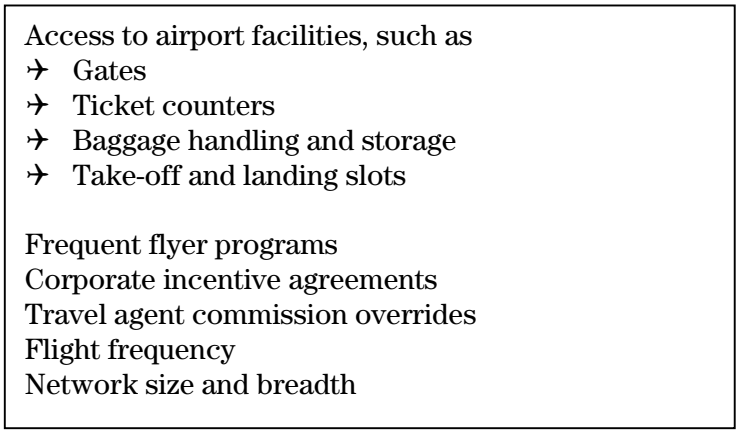
[3]Fares and passenger totals shown are for Southwest's service from Houston's Hobby Airport and for Continental's service from Houston's Bush Intercontinental Airport.

[4]Fares and passenger totals shown are for US Airways' service to Chicago's O'Hare International Airport.

Source: GAO's analysis of data from BACK Aviation Solutions.

The other way dominant carriers may exercise market power is to employ operating and marketing barriers to limit the ability of airlines to enter and compete in new markets. Figure 2 lists the wide range of operating and marketing barriers available to the large dominant network carriers for either deterring entry into their dominated markets or for reducing the competitive threat from new or existing carriers. A difficult issue to decide is whether exercising these barriers or operating practices represents vigorous competition or anticompetitive practices.

Figure 2: Operating and Marketing Barriers Which Constrain New Entry into Dominated Markets



In 1999, we reported that competition in certain key airports continued to be inhibited by slot controls, federal and local perimeter rules, and lack of access to facilities.[14] Airfares at these airports, including Pittsburgh and Reagan Washington National, were consistently higher than at airports of comparable size without constraints. Previously, new airlines (i.e., those that began operations after the deregulation of the industry) reported difficulty gaining competitive access to gates at six airports--Charlotte, Cincinnati, Detroit, Minneapolis, Newark, and Pittsburgh. Although some of these airports now have a limited number of gates available, the vast majority of gates continue to be leased to one established airline. Airport and airline officials also told us that factors other than restrictive gate leases, such as the marketing strategies of incumbent airlines, prevented new entrants from providing service at their airports. These marketing strategies, combined with a new entrant's fear of perceived predatory conduct by the incumbent carrier and its possible lack of adequate capitalization, can deter airlines from entering dominated markets.

Airline sales and marketing practices (such as frequent flyer programs, travel agent commission overrides, or corporate incentive agreements[15]) make it difficult for potential competitors to

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[14] *Airline Deregulation: Changes in Airfares, Service Quality, and Barriers to Entry*, GAO/RCED-99-92, March 4, 1999.

[15] Under frequent flier programs, passengers qualify for awards by flying a certain number of miles with the sponsoring airline. A travel agent commission override is a special bonus commission paid by airlines to travel agents or agencies as a reward for booking a targeted proportion of passengers on their airline. Corporate incentive agreements represent offers by airlines to corporate clients for fares that are discounted from the prices that are otherwise applicable. They may be stated as percentage discounts from specified published fares.

enter markets dominated by established airlines. As we have previously reported, the dominant carrier in each market uses these strategies to attract the most profitable segment of the industry--business travelers. Since the strength of these programs depends largely on the incumbent airline's route networks, alliances, and hubs, new entry carriers who lack such tools are concerned about their ability to enter the market successfully. Therefore, airlines in many cases have chosen not to enter, or to quickly exit, markets where they did not believe they could overcome the combined effect of these strategies. This is particularly true given that, to attract new customers, a potential competitor must announce its schedule and fares well in advance of beginning service. Thus, the incumbent is provided an opportunity to adjust its marketing strategies and match the low fares offered by the new competitors.

Federal Oversight of Competition in the Airline Industry

Both DOJ and DOT have responsibilities for prohibiting unfair competitive practices but only DOJ has responsibility for taking actions against mergers. Initially, DOT had inherited the Civil Aeronautics Board's antitrust responsibilities. In the 1980s, it approved a wave of mergers, including two--Northwest's acquisition of Republic and TWA's acquisition of Ozark--that DOJ urged it to oppose. Congress subsequently removed DOT's authority for approving airline mergers, giving that responsibility to DOJ.

DOJ's authority to review airline mergers and prohibit anticompetitive behavior comes from the Sherman and Clayton Antitrust Acts and the Hart-Scott-Rodino Act. DOJ exercised this authority in filing a complaint against the Northwest-Continental proposed stock acquisition. Proposed in 1998, this acquisition gave Northwest 51 percent of the voting rights in Continental. In January 2001, DOJ dismissed its lawsuit Northwest divested all but 7 percent of its voting interest in Continental. In a case involving alleged predatory practices that is still pending, DOJ exercised its authority under the Sherman Antitrust Act to prevent monopolization by filing a complaint in 1999 against American Airlines. DOJ alleged that American violated the Sherman Act by attempting to monopolize service out of Dallas-Fort Worth by increasing capacity and reducing fares "well beyond what makes business sense," to drive new competitors, such as Vanguard and Western Pacific airlines, out of the market.

DOT has no current authority to approve mergers, but it does have general authority under 49 USC 41712 to act against what it considers to be an unfair or deceptive practice or an unfair method of competition in air transportation. DOT has used this authority to investigate several complaints of predatory practices by major air carriers against new entrants. Based on these complaints, DOT in April 1998 proposed guidelines that sought to define standards for air carrier conduct. However, DOT did not finalize or implement those guidelines, concluding instead that it should develop standards through a case by case approach.[16] Today, it is unclear the extent to which DOT's authority under section 41712 extends with regard to predatory practices. Because DOT has not yet exercised its authority, the way in which this provision will be interpreted and applied is unclear.

The Wendell H. Ford Aviation Investment and Reform Act for the 21st Century[17] (AIR-21) required certain large and medium hub airports to submit annual competition plans to DOT in order for the airport to receive new federal grants or to impose or increase the passenger facility charge. The plans are to include information on the availability of airport gates and other facilities, gate-use requirements, patterns of air service, financial constraints, and other specific items. Starting in fiscal year 2001, all covered airports are required to have their plans reviewed by the Federal Aviation Administration (FAA) in order to receive Airport Improvement Program (AIP) grants and new authority to levy passenger facility charges.[18] DOT is to review the plans and their implementation to ensure that each covered airport successfully implemented its plan.

Proposed Legislation Focuses on Significant Impediments to Competition

While we have had only limited time to study the proposed legislation, we are nevertheless pleased to provide some broad comments on the intent and a few key provisions. The intent of the Aviation Competition Restoration Act to ensure "competitive access by commercial air

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[16] DOT reported in January that its review of the TRB report on the proposed guidelines, along with additional analyses, confirmed that airlines engage at times in unfair competitive practices designed to eliminate or reduce competition and that it should take action to prevent such practices.

[17] P.L. 106-181

[18] Passenger facility charges, authorized originally in the Aviation Safety and Capacity Expansion Act of 1990, are fees levied by local airports (with the approval of the FAA) on enplaned passengers. The charges may broadly be used to (1) preserve or enhance airport safety, security, or capacity; (2) reduce noise; or (3) enhance airline competition.

carriers to major cities" is clearly sound. The benefits of preserving and enhancing competition in the airline industry to the public are indisputable. The absence of effective access to markets goes to the heart of failures in the functioning of competition in so many markets. Under current law, DOT has the authority to take action against anticompetitive practices, but it is not required to take any action. The proposed legislation would expressly require DOT to act. We fully concur with the finding that "public concern about the importance of air transportation… and continued hub domination requires the Department of Transportation to assert its authority in analyzing proposed transactions among air carriers that affect consumers." Moreover, as noted in the bill's findings, many of the other concerns of the public and Congress regarding the airline industry--increasing flight delays and cancellations, overscheduling, and poor service--are linked to weaknesses in the functioning of competition.

We do, however, have some concerns that the proposed bill may be too prescriptive – and either may not result in the intended effect or produce unintended adverse effects. These comments relate primarily to the provisions of Section 3 which may be more specific than necessary in specifying solutions to potentially anti-competitive effects of proposed mergers[19] – when in practice both problems and solutions could vary from airport to airport, market to market, and carrier to carrier. Below are two examples of these concerns:

- ***Forced divestiture of airport "assets" may not necessarily result in real price competition in high-value business markets.*** Fares may fall only in markets where competition is effectively introduced from a low-fare carrier rather than another network carrier. Were another network carrier to enter against an incumbent dominant airline, it may offer little if any price competition. The new competing network carrier may or may not have a cost advantage relative to the incumbent dominant airline. Moreover, an airline may be reluctant to enter or cut prices in a market where its rival has a large market share for fear that the rival would retaliate by cutting prices in markets where it has a large share—a practice known as "mutual forbearance." For new entrant airlines, access to an airport through its slots, gates, and facilities is necessary but not sufficient

[19] For example, care would be needed in crafting the final language for the DOT role in reviewing mergers to assure consistency with DOJ's authority under the antitrust laws.

as dominant incumbent airlines' sales and marketing practices may make competitive entry difficult if not impossible.

- ***Service to small communities could likely be the first casualty of forced divestiture of critical assets.*** Depending upon how intensively the dominant airline uses its gates and other facilities at an airport, a requirement that they surrender such assets could negatively affect the airline's ability to maintain service to its spoke communities. Airlines forced to reduce service would be expected to eliminate flights to and from communities that provide the least profit—likely smaller communities. Based on the pattern of service provided by low-cost airlines such as Frontier, Spirit, and JetBlue, each of which generally fly only to larger communities, there is no guarantee that new entrant low-fare carriers would choose to serve smaller markets abandoned by incumbent airlines. Similarly, other network carriers that might initiate service at the hub would also be unlikely to use that facility to begin service to routes they could more profitably serve from their own hubs. However, if dominant airlines could increase the frequency with which they use their gates, facilities, and other assets, service to smaller communities may be little affected.

Other provisions of the proposed legislation appear to provide clear direction regarding DOT actions to exercise its current authority to preserve and enhance industry competition. Section 4 requires DOT to undertake a review of access in the nation's 35 largest airports and authorizes the Secretary to require carriers to provide access at reasonable rates. Section 6 conditions approval of AIP funds and approval of Passenger Facility Charges on an airport sponsor assuring open access to the airport. We have expressed concern about restrictions on access to essential airport facilities functioning as an important barrier to entry. As early as 1996 we recommended that DOT be actively aware of airport and airline practices at the major airports and condition approval of AIP funds on appropriate remedies being instituted. Thus, we fully support the intent of these provisions. Again, however, the specific language might be clarified to focus more on the intended result. For example, AIR 21 already requires the Secretary to ensure "that gates and other facilities are made available at costs that are fair and reasonable to air carriers at covered airports where a "majority-in-interest clause" of a contract or other agreement or arrangement inhibits the ability of the local airport authority to provide or build new gates or

other facilities" (Section 155(d)). Potentially there may be more value in calling for a status report on DOT's implementation of their existing authority.[20]

Overall, we recognize that the proposed legislation seeks to focus DOT's wide discretion under their current authority and direct a more activist role in overseeing, promoting and enhancing competition among carriers, as well as assuring a pro-competitive role by airport operators. In this regard, we would suggest that there are a wide range of DOT and FAA policies, resources, tools and practices which affect competition in the airline industry which should be both better understood and more strategically aligned. One prominent area where a clearly anti-competitive "temporary" policy has been perpetuated for decades is DOT's administration of "slots" at high density airports. Another area not addressed in the proposed legislation is DOT's inaction to fully investigate and remedy persistent charges of predatory actions by major network carriers to the entry by low cost carriers in their dominated markets in a timely manner.

In short, a dramatic shift of emphasis, commitment and resources is required for DOT to fully address their existing authority and responsibility for protecting and preserving competition in the airline industry. The proposed legislation makes clear many of the key areas where DOT could and should be present in overseeing and enforcing principles of fair competition. The legislation would underscore Congressional intent for an activist oversight role. The major remaining gap – whether or not the proposed legislation becomes law – is the adequacy of resources and technical capacity within DOT to fulfill this vital role. Over the past several years, DOT has lost considerable expertise in airline competition issues due to staff attrition. This expertise needs to be replenished if DOT is to undertake an assertive role in overseeing airline competition. For example, DOT's ability to pursue investigations of potentially unfair competition is constrained by the limited available resources in the Office of the Assistant General Counsel for Aviation Enforcement and Proceedings and the Office of the Assistant Secretary for Aviation Affairs. Perhaps one way for the committee to promote an activist role by DOT could be to require the Secretary of Transportation to make an immediate assessment of

[20] For example, the FAA/Office of the Secretary of Transportation Task Force Study on "Airport Business Practices and Their Impact on Airline Competition" (October 1999) already outlined a number of specific measures that were needed to ensure competitive access at major airports, including best practices that they identified for replication by various airports. In addition, the recently required airport competition plans have recently been received in DOT. The Committee may want to consider calling for an update on

the resources available and required to fulfill their existing responsibilities under old Section 411 and AIR 21, the resources needed to implement the proposed legislation, and to develop a strategic plan for meeting these responsibilities.

Conclusions

The major network carriers dominate traffic at most of their large hubs and there is extensive evidence that fares in markets where competition is absent are consistently above competitive levels. We believe that the oversight scheme contemplated when the industry was deregulated – with antitrust enforcement by the DOJ and oversight of unfair trade practices by DOT - has not been entirely successful in preserving and assuring the functioning of competition. In particular, while the current legislative scheme grants explicit authority for DOT to regulate unfair competitive practices, the legislation does leave substantial discretion with DOT on the scope of their action, if any. Thus, with the range of competitive challenges confronting the industry and directly affecting consumers, especially in the face of unprecedented industry consolidation, we believe there is merit in the overall intent of the bill to direct DOT to actively monitor the state of competition in the industry, and to institute remedial actions as appropriate – both through recommendations to DOJ as well as actions on their own – and all with open reporting to the Congress and the public.

This concludes my statement. I would be pleased to answer any questions you or other Members of the Committee might have.

Contact and Acknowledgments

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the 1999 report and the status of specific actions DOT has taken and are underway to assure airports are meeting their obligations to ensure competitive access to airports.

Appendix I

Large Hub Airports and Airlines That Carried the Largest Percentage of Passengers Carried (Market Share), 4th Quarter 1999 Through 3rd Quarter 2000

Hub	Largest airline	Market share	Second largest airline	Market share	Total passengers[1]
Atlanta	Delta	74.3	Air Tran	10.3	37,606,932
Chicago O'Hare	United	49.7	American	33.1	34,418,016
Los Angeles Int'l	United	28.9	American	16.0	30,436,893
Dallas/Ft. Worth	American	60.7	Delta	18.8	28,074,665
San Francisco	United	51.4	American	10.5	19,262,805
Denver	United	69.5	Frontier	8.0	18,148,611
Detroit	Northwest	77.0	Southwest	3.4	16,910,175
Newark	Continental	53.3	Delta	9.0	16,794,443
Miami	American	53.5	Delta	10.2	16,561,634
Phoenix	America West	41.1	Southwest	30.8	16,316,300
Las Vegas	Southwest	32.8	America West	17.2	15,630,979
Minneapolis	Northwest	79.5	Sun Country	4.5	15,422,494
New York Kennedy	American	24.3	Delta	20.3	15,244,975
Houston Bush Intercon.	Continental	83.0	American	3.8	14,996,958
St. Louis	Trans World	71.7	Southwest	14.9	14,831,699
Orlando	Delta	29.4	US Airways	14.3	13,780,567
Seattle	Alaska	30.8	United	14.5	13,377,182
Boston	Delta	24.4	US Airways	20.4	13,090,336
New York LaGuardia	Delta	26.4	US Airways	19.8	11,769,143
Philadelphia	US Airways	63.4	Delta	7.6	11,711,796
Cincinnati	Delta	94.3	Northwest	2.9	10,801,642
Charlotte	US Airways	90.0	American	1.6	10,754,284
Honolulu	Hawaiian	32.9	Aloha	29.5	10,611,794
Pittsburgh	US Airways	85.8	Delta	3.5	9,480,757
Salt Lake City	Delta	71.7	Southwest	13.4	9,472,439
Washington Dulles	United	54.4	US Airways	14.4	8,824,447
Baltimore	Southwest	38.3	US Airways	26.4	8,316,697
San Diego	Southwest	35.3	United	15.3	7,550,495
Tampa	Delta	21.4	Southwest	19.7	7,348,044
Reagan National	US Airways	32.4	Delta	19.7	7,277,596
Fort Lauderdale	Delta	27.1	US Airways	15.6	6,858,842
Total					**471,683,640**

[1] Data for total passengers represent passenger enplanements (i.e., passengers boarding an aircraft). Thus, for example, a passenger that must make a single connection between his or her origin and destination counts as two enplaned passengers because he or she boarded two separate flights.

Source: GAO's analysis of data from the Federal Aviation Administration and BACK Aviation Solutions.

Related GAO Products

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